Q2

What are the causes of persistent high food inflation in India? Comment on the effectiveness of the monetary policy of RBI to control this type of inflation.

UPSC Civil Services Mains 2024 · GS III · 10 marks · Indian Economy

Indian Economy and issues relating to planning, mobilization of resources, growth, development and employment.

Core demand of the question

- Name the causes of persistent high food inflation in India
- Comment on how far RBI monetary policy can control this type of inflation
- Keep food as a supply-and-market problem, not only a money problem

Revision summary

Indian food inflation is kept high by weather, perishable supply chains, rising protein demand, cereal floors and edible-oil imports.

It is mainly a supply and market problem, not a pure money problem.

RBI repo hikes cool demand and second-round wage effects; they do not grow a crop.

Flexible inflation targeting still must watch food because food sits inside CPI.

First-best tools are buffers, storage, timed imports and better mandis; monetary policy is the anchor.

Introduction

India's poor live on a **food-heavy CPI basket**. When onion, tomato, pulse or cereal prices stay high, **headline inflation** hurts them first. That pain has been **persistent** in several phases of the last two decades, even when industrial prices were quiet. The causes sit mostly on the **farm and the mandi**. The **RBI's interest rate** is a blunt tool against a failed monsoon.

Body

Why food inflation stays high

Food inflation in India is **recurring**, not a one-season accident. **Weather and climate** still swing output of onion, tomato, potato and pulses. **Small farms, weak storage and a long mandi chain** turn a local shortfall into a national spike. **Protein demand** (milk, egg, meat, pulses) rises with income faster than supply. **MSP and procurement** support cereal floors, which can hold rice and wheat up even when global prices ease. **Export bans and stocking limits** try to cool retail prices and often **scare planting** the next season. Fuel, freight and wages feed into farm costs. Global edible oil and fertiliser shocks pass through because India **imports** those. Hoarding and thin futures markets add noise. The result is a **high-frequency, supply-heavy** inflation, concentrated in a few perishable items that dominate the household's kitchen.

- **Peg:** Onion, tomato and pulses have repeatedly led CPI-food spikes even when core inflation was softer.
- **Peg:** Edible oils show how an import bill becomes kitchen inflation.

What monetary policy can and cannot do

The RBI's **flexible inflation targeting** (4 per cent CPI, with a band of two points either side) uses the **repo rate** to cool **demand**. That works better on **core** prices - services, durables, housing - than on a **failed kharif pulse crop**. A rate hike cannot harvest a tomato. It can, with a lag, slow the **second-round** pass-through into wages and expectations, and it can police a **credit boom** that would otherwise lift all prices. If the RBI chases every food spike with a hike, it **hurts growth and jobs** without planting a single acre. If it ignores a food spike that lasts, **inflation expectations** unhinge. The honest comment is therefore **limited short-run effectiveness, useful as an anchor**. Food inflation needs **buffer stocks, storage, import timing, competition in mandis, and climate-resilient horticulture**. Monetary policy is the backstop, not the farm ministry.

- **Peg:** The 2016 monetary-policy framework made CPI the target; food is inside that CPI, which is why the RBI must explain food even when it cannot grow it.
- **Peg:** Supply action (open-market sale, import, onion buffer) is the first-best tool; the repo is the second-best.

Flow diagram

Weather storage protein -> Food CPI

Mandi and import shocks -> Food CPI

Food CPI -> Headline inflation

Repo rate -> Core and expectations

Core and expectations -> Headline inflation

Buffers and supply action -> Food CPI

Conclusion

Persistent food inflation comes from weather, storage, protein demand, import dependence and mandi frictions. RBI policy can hold the second round and the target's credibility. It cannot replace a working farm-to-kitchen chain.

Facts & figures

Flexible inflation targeting

Since 2016 the RBI targets 4 per cent CPI with a plus-or-minus two-point band, under a statutory MPC.

Food in CPI

Food and beverages have a large weight in India's consumer price index, so kitchen prices move headline inflation.

Perishables
Onion, tomato and potato cycles are a repeated source of short, sharp CPI spikes.

Edible oil
India depends on imported vegetable oils, so global prices pass through to domestic food inflation.

Second-round effect
A lasting food spike can lift wages and expectations; that is the channel where monetary policy has more bite.